

UNITED STATES DISTRICT COURT  
CENTRAL DISTRICT OF CALIFORNIA

UNITED STATES COMMODITY  
FUTURES TRADING COMMISSION,

Plaintiff,

vs.

20/20 TRADING COMPNAY, INC., 20/20  
PRECIOUS METALS, INC., BHARAT  
ADATIA, SHARIEF D. McDOWELL,  
AND TODD KREJCI

Defendants.

CASE NO. SACV 11-643-JST (FMOx)

**ORDER DENYING MOTION FOR  
PRELIMINARY INJUNCTION,  
DISSOLVING THE STATUTORY  
RESTRAINING ORDER, AND  
TERMINATING THE TEMPORARY  
RECEIVER'S APPOINTMENT**

1           **I. INTRODUCTION**

2           Before the Court is Plaintiff the United States Commodity Futures Trading  
3 Commission’s (“CFTC”) motion for a preliminary injunction pursuant to 7 U.S.C. § 13a-  
4 19(a). (Doc. 2.) The CFTC bases the motion on claims three and four in the Complaint,  
5 which allege that Defendants 20/20 Precious Metals, Inc. (“20/20 Metals”), Bharat Adatia,  
6 Todd Krejci, and Sharief McDowell violated Section 19 of the Commodity Exchange Act  
7 (“the Act”), 7 U.S.C. § 23, by committing fraud in connection with certain leverage  
8 transactions and by entering into certain leverage transactions involving palladium and  
9 copper. (Compl., Doc. 1, ¶¶ 79-90.) Having considered the parties’ briefs and having  
10 heard oral argument, the Court DENIES CFTC’s motion for a preliminary injunction,  
11 dissolves the statutory restraining order, and terminates the temporary receiver’s  
12 appointment.

13

14           **II. BACKGROUND**

15           The Complaint alleges the following facts. 20/20 Trading Company, Inc. (“20/20  
16 Trading”) was a Nevada corporation with its principal place of business in Laguna Niguel,  
17 California, that ceased doing business in October 2009. (*Id.* ¶ 16.) 20/20 Metals is a  
18 Nevada corporation with its principal place of business in Laguna Niguel. (*Id.* ¶ 17.)  
19 Adatia was a principal, director, and the president of 20/20 Trading, and is the president  
20 and director of 20/20 Metals. (*Id.* ¶ 18.) McDowell was a principal of 20/20 Trading and  
21 is a salesperson for 20/20 Metals. (*Id.* ¶ 19.) Krejci is a salesperson for 20/20 Metals. (*Id.*  
22 ¶ 20.)

23           Between January 2006 and October 2009, McDowell, in her capacity as a principal  
24 and salesperson of 20/20 Trading and under Adatia’s supervision, solicited prospective  
25 customers by telephone to open commodity options trading accounts with 20/20 Trading.  
26 (*Id.* ¶ 28.) McDowell allegedly misled prospective customers regarding the likelihood of  
27 profiting from trading commodity options, the risk involved in the activity, and the  
28 performance of 20/20 Trading’s customers. (*Id.* ¶ 29.) Throughout this period, once

1 prospective customers signed on to 20/20 Trading, 20/20 Trading assisted customers in  
2 establishing a future commission merchant (“FCM”) and acted as an intermediary by  
3 placing trades in the FCM accounts on behalf of its customers, earning allegedly exorbitant  
4 commissions for each trade placed in those accounts. (*Id.* ¶ 36.) McDowell also allegedly  
5 continued to mislead customers. (*Id.* ¶¶ 37-42.) This led to 20/20 Trading customers  
6 losing in excess of \$3.8 million during this period, with approximately 63% of those losses  
7 resulting from 20/20 Trading’s commissions. (*Id.* ¶ 43.) Adatia closed 20/20 Trading in  
8 October 2009. (*Id.* ¶ 45.)

9       Shortly after 20/20 Trading shut down, Adatia established 20/20 Metals as a  
10 business that offered and entered into transactions with customers for the purchase of gold,  
11 silver, platinum, palladium, and copper. (*Id.* ¶ 46.) 20/20 Metals solicits customers  
12 through its website, [www.20-20preciousmetals.com](http://www.20-20preciousmetals.com), and third-party leads. (*Id.* ¶¶ 48 -50.)  
13 In their telephone solicitations, McDowell and Krejci informed prospective customers that  
14 (a) 20/20 Metals purchases physical metals for its customers; (b) customers receive title to  
15 those metals; (c) 20/20 Metals will arrange financing for up to 75% of the purchase price  
16 of the metals; (d) 20/20 Metals ensures that its customers’ physical metals are stored in a  
17 secure depository; and (e) the customer incurs interest, storage fees, and other charges in  
18 connection with the purchase. (*Id.* ¶ 51.) The CFTC alleges that although 20/20 Metals  
19 claims to offer its customers investments in actual physical metals, most customers are  
20 purchasing metals on a leveraged basis, not taking delivery of the metals, and utilizing the  
21 transactions merely to speculate on the price of metals. (*Id.* ¶¶ 46-47.) The CFTC alleges  
22 that instead of purchasing actual metals for its customers, 20/20 Metals sends the funds to  
23 a third party, Hunter Wise Commodities, LLC (“HWC”), who then uses the funds to enter  
24 into leverage transactions in the name of 20/20 Metals. (*Id.* ¶ 56.) The CFTC alleges that  
25 20/20 Metals does not purchase the metals, pass title to the metals to the customers, or  
26 store the metals in a secure depository. (*Id.* ¶ 60.) 20/20 Metals also allegedly does not  
27 arrange for or obtain financing for the leveraged portions of its customers’ purchases.  
28 Instead, 20/20 Metals allegedly misinforms their customers that a loan has been made to

1 them in the amount of the difference between the total value of the metals they purchased  
2 and the funds they have deposited with 20/20 Metals, minus commissions, and then  
3 fraudulently charges customers interest on these non-existing loans and storage fees for  
4 non-existing metals. (*Id.* ¶¶ 61-63.) Since 20/20 Metal's inception in late 2009, its  
5 customers have alleged deposited over \$1 million in 20/20 Metal accounts, and 20/20  
6 Metals has taken commissions of over \$400,000. (*Id.* ¶ 65.)

7 On April 26, 2011, the CFTC filed a Complaint (Doc. 1), a motion for a preliminary  
8 injunction (Doc. 2), and a motion for a statutory restraining order (Doc. 3) against  
9 Defendants. The Complaint alleges four claims for violation of the Act. The CFTC brings  
10 the first claim against 20/20 Trading, Adatia, and McDowell for commodity options fraud  
11 in violation of 7 U.S.C. § 6c(b) and 17 C.F.R. § 33.10. (Compl. ¶¶ 66-73). The CFTC  
12 brings the second claim against 20/20 Trading and Adatia for failure to supervise in  
13 violation of 17 C.F.R. § 166.3. The events which form the basis for claims one and two  
14 occurred at 20/20 Trading between January 2006 and October 2009. (*Id.* ¶¶ 74-78.)

15 In contrast, claims three and four are brought against 20/20 Metals, Adatia,  
16 McDowell, and Krejci, and are based on events that occurred from late 2009 through the  
17 present at 20/20 Metals. (*Id.* ¶¶ 81, 87.) Specifically, claim three alleges that 20/20  
18 Metals, Adatia, McDowell, and Krejci violated 7 U.S.C. § 23 and 17 C.F.R. § 31.3 by  
19 committing fraud in connection with certain leverage transactions. (*Id.* ¶¶ 79-85.) Claim  
20 four alleges that these Defendants violated 7 U.S.C. § 23 by executing certain leverage  
21 transactions involving copper and palladium. (*Id.* ¶¶ 86-90.) The motions for a  
22 preliminary injunction and statutory restraining order are based solely on claims three and  
23 four in the Complaint, which involve 20/20 Metals, not 20/20 Trading.

24 On April 27, 2011, the Court issued a statutory restraining order, appointed a  
25 temporary receiver, and set a hearing for CFTC's motion for a preliminary injunction.  
26 (Doc. 13.) On June 6, 2011, the Court held a hearing on the motion for preliminary  
27 injunction.

28

1           **III.    LEGAL STANDARD**

2           “A preliminary injunction is an extraordinary and drastic remedy.” *Munaf v. Geren*,  
3 553 U.S. 674, 676 (2008). “The purpose of a preliminary injunction is merely to preserve  
4 the relative positions of the parties until a trial on the merits can be held.” *Univ. of Tx v.*  
5 *Camenisch*, 451 U.S. 390, 395 (1981). A district court should issue a preliminary  
6 injunction only “upon a clear showing that the plaintiff is entitled to such relief.” *Winter v.*  
7 *Natural Res. Def. Council, Inc.*, 555 U.S. 7, 129 S. Ct. 365, 376 (2008). This requires the  
8 district court to make findings of fact and conclusions of law. *Perfect 10, Inc. v.*  
9 *Amazon.com, Inc.*, 508 F.3d 1146, 1157 (9th Cir. 2007); *see LGS Architects, Inc. v.*  
10 *Concordia Homes of Nev.*, 434 F.3d 1150, 1155 (9th Cir. 2006).

11            “[T]he party seeking the injunction . . . bear[s] the burden of demonstrating the  
12 various factors justifying preliminary injunctive relief . . . .” *Granny Good Foods, Inc. v.*  
13 *Bhd. of Teamsters*, 415 U.S. 423, 441 (1974). “A plaintiff seeking a preliminary injunction  
14 must establish that he is likely to succeed on the merits, that he is likely to suffer  
15 irreparable harm in the absence of preliminary relief, that the balance of equities tips in his  
16 favor, and that an injunction is in the public interest.” *Winter*, 129 S. Ct. at 374. This  
17 “requires the plaintiff to make a showing on all four prongs.” *Alliance for the Wild Rockies*  
18 *v. Cottrell*, 632 F.3d 1127, 1135 (9th Cir. 2011).

19            The Ninth Circuit employs the “serious questions” version of the “sliding scale”  
20 approach when applying the four-element *Winter* test. *Id.* at 1134. “That is, ‘serious  
21 questions going to the merits’ and a balance of hardships that tips sharply towards the  
22 plaintiff can support issuance of a preliminary injunction, so long as the plaintiff also  
23 shows that there is a likelihood of irreparable injury and that the injunction is in the public  
24 interest.” *Id.* at 1135.

25

26

27

28

1                   **IV. MOTION TO STRIKE DECLARATIONS**

2                   On May 23, 2011, the CFTC filed a motion to strike declarations submitted by  
3 Defendants' expert Philip A. Feigin and Defendant Adatia. (Doc. 56.) Because the CFTC  
4 did not file the motion 28 days before hearing date, the Court treats the motion as an  
5 objection to such evidence. *See* C.D. Cal. R. 6-1 ("The notice of motion shall be filed with  
6 the Clerk not later than twenty-eight (28) days before the date set for hearing . . . ."). The  
7 CFTC argues that the Court should strike the declarations because they contain improper  
8 legal opinions and conclusions. (*Id.* at 2.) The Court's Order does not rely on the  
9 substance of either declaration, and therefore does not rely on any alleged legal  
10 conclusions or opinions made by either. Thus, the Court DENIES the CFTC's objection as  
11 moot.

12                   **V. DISCUSSION**

13                   Defendants argue that the Court should not issue a preliminary injunction, and  
14 rather should dissolve the existing statutory restraining order, because the CFTC does not  
15 have jurisdiction over claims three and four in the Complaint. Defendants mistakenly  
16 argue that because the CFTC does not have jurisdiction over claims three and four, the  
17 Court does not have subject matter jurisdiction over the claims. (Defs.' Opp. at 4); *see*  
18 *CFTC v. White Pine Trust Corp.*, 574 F.3d 1219, 1222 n.2 (9th Cir. 2009) (noting that  
19 defendant confused an attack on the CFTC's jurisdiction with the district court's subject  
20 matter jurisdiction). The Court has subject matter jurisdiction pursuant to 28 U.S.C. §  
21 1331 because the CFTC brings the claims pursuant to a federal law, the Commodities  
22 Exchange Act. *Id.* Nonetheless, Defendants' argument that the CFTC lacks jurisdiction  
23 over claims three and four is "akin to a claim that there is no cause of action provided by  
24 the statute," which on a motion for preliminary injunction can be read as an argument  
25 going to the likelihood of success on the merits. *Id.* The CFTC counters that it has  
26 jurisdiction to bring claims three and four under 7 U.S.C. § 23 because the types of  
27 contracts 20/20 Metal was entering into with its customers "are precisely the type of  
28

1 transactions identified in Section 19.” (Pl.’s Reply at 12.) Thus, the question before the  
2 Court is whether the CFTC has jurisdiction over claims three and four.

3

4       A. Injunctive Relief Under the Act

5       Section 6c(a) of the Act, 7 U.S.C. § 13a-1(a), grants the CFTC authority to seek and  
6 the Court to grant injunctive relief:

7               Whenever it shall appear to the Commission that any registered entity  
8               or other person has engaged, is engaging, or is about to engage in any  
9               act or practice constituting a violation of any provision of this chapter  
10               or any rule, regulation, or order thereunder, or is restraining trading in  
11               any commodity for future delivery, the Commission may bring an  
12               action in the proper district court of the United States or the proper  
13               United States court of any territory or other place subject to the  
14               jurisdiction of the United States, to enjoin such act or practice, or to  
15               enforce compliance with this chapter, or any rule, regulation or order  
16               thereunder, and said courts shall have jurisdiction to entertain such  
17               actions . . . .

18       7 U.S.C. § 13a-1(a). However, “[s]tanding alone, these subsections grant no jurisdiction;  
19       the CFTC must allege and . . . show a violation of the Act or of its regulations.” *White*  
20 *Pine Trust*, 574 F.3d at 1223. Because the CFTC brings the motion for preliminary  
21 injunction based solely on alleged violations of 7 U.S.C. § 23, the Court must determine  
22 whether the alleged “leverage transactions” in claims three and four fall under the CFTC’s  
23 jurisdiction under that provision.

24

25       B. The CFTC’s Jurisdiction Under 7 U.S.C. § 23

26       The jurisdiction of the CFTC derives from section 2 of the Act. *White Pine Trust*,  
27 574 F.3d at 1223 (when determining the CFTC’s jurisdiction, “all roads lead back to  
28 section 2 of the Act”). Section 2 establishes that the CFTC shall have exclusive

1 jurisdiction over “transactions subject to regulation by the Commission pursuant to section  
2 23 of this title.” 7 U.S.C. § 2(a)(1)(A). 7 U.S.C. § 23(a), in turn, provides:

3 Except as authorized under subsection (b) of this section, no person  
4 shall offer to enter into, enter into, or confirm the execution of, any  
5 transaction for the delivery of any commodity under a standardized  
6 contract commonly known to the trade as a margin account, margin  
7 contract, leverage account, or leverage contract, or under any contract,  
8 account, arrangement, scheme, or device that the Commission  
9 determines serves the same function or functions as such a standardized  
10 contract, or is marketed or managed in substantially the same manner  
11 as such a standardized contract.

12 7 U.S.C. § 23(a). Under 7 U.S.C. § 23(b),

13 Subject to paragraph (2), no person shall offer to enter into, enter into,  
14 or confirm the execution of, any transaction for the delivery of silver  
15 bullion, gold bullion, bulk silver coins, bulk gold coins, or platinum  
16 under a standardized contract described in subsection (a) of this  
17 section, contrary to the terms of any rule, regulation, or order that the  
18 Commission shall prescribe, which may include terms designed to  
19 ensure the financial solvency of the transaction or prevent manipulation  
20 or fraud.

21 7 U.S.C. § 23(b)(1). The CFTC contends that the contracts 20/20 Metal entered into with  
22 its customers were “Section 19” contracts under 7 U.S.C. § 23. (Pl.’s Mot. at 6-7; Pl.’s  
23 Reply at 3-5, 12-20.) Defendants argue that the contracts in question were not “leverage  
24 contracts,” as defined by 17 C.F.R. § 31.4(w) (“Regulation 31.4(w”), and thus do not fall  
25 under 7 U.S.C. § 23. The CFTC argues that leverage contracts are but one type of  
26 standardized contract encompassed by 7 U.S.C. § 23 and that the “broad” grant of

27

28

1 jurisdiction under 7 U.S.C. § 23 is not restricted by Regulation 31.4(w)'s definition of a  
2 leverage contract.<sup>1</sup> (Pl.'s Reply 3, 6-7.) Thus, the Court must decide whether the CFTC's  
3 jurisdiction under 7 U.S.C. § 23 is contingent on Regulation 31.4(w)'s definition of  
4 "leverage contracts."  
5

6       C. Section 19 Contracts vs. Leverage Contracts

7       The plain language of 7 U.S.C. § 23(a) restricts the CFTC's jurisdiction under that  
8 section to "a standardized contract commonly known to the trade as a margin account,  
9 margin contract, leverage account, or leverage contract, or under any contract, account,  
10 arrangement, scheme, or device that the Commission determines serves the same function  
11 or functions as such a standardized contract, or is marketed or managed in substantially the  
12 same manner as such a standardized contract." 7 U.S.C. § 23(a). "In 1984, the [CFTC]  
13 issued comprehensive regulations to govern leverage transactions," and in doing so, "set  
14 forth a narrow definition of a leverage contract" in Regulation 31.4(w). *First Nat.*  
15 *Monetary Corp. v. CFTC*, 860 F.2d 654, 658 (6th Cir. 1988); *see* 17 C.F.R. §§ 31.1 –  
16 31.26. Regulation 31.4(w) defines a leverage contract as "a contract, standardized as to  
17 terms and conditions, for the long-term (ten years or longer) purchase ('long leverage  
18

19

---

20       <sup>1</sup> The CFTC argues that Defendants have failed to offer authorities that establish that the  
21 CFTC lacks jurisdiction over said contracts. (Pl.'s Reply at 8-12.) Because it is the CFTC's  
22 burden to establish jurisdiction to prosecute its claims, this argument is unavailing. The CFTC  
23 also devotes a substantial part of its reply brief to Defendants' alleged fraud in violation of 17  
24 C.F.R. § 31.3. (*Id.* at 4-5, 17-20.) Whether Defendants committed fraud, however, is irrelevant to  
25 the preliminary question of whether the CFTC has jurisdiction over the contracts and transactions  
26 in question. *See CFTC v. Zelener*, 373 F.3d 861,867 (7th Cir. 2004) ("The Commission's  
27 principal substantive contention is that [defendant] deceived its clients. That could form the basis  
28 of a mail-fraud or wire-fraud prosecution, a civil or criminal action under RICO, or fraud litigation  
in state court. Consumers or state attorneys general could involve consumer-protection laws as  
well. It is unnecessary to classify the transaction as future contracts in order to provide remedies  
for deceit. Why stretch the Commodity Futures Act – with resulting uncertainty, litigation costs,  
and potentially unhappy consequences for other economic arrangements that may be swept into a  
regulatory system not designed for them – when other remedies are ready to hand?").

1 contract') or sale ('short leverage contract') by a leverage customer of a leverage  
2 commodity which provides for":

- 3 (1) Participation by the leverage transaction merchant as a principal in  
4 each leverage transaction;
- 5 (2) Initial and maintenance margin payments by the leverage customer;
- 6 (3) Periodic payment by the leverage customer or accrual by the  
7 leverage transaction merchant of a variable carrying charge or fee on  
8 the unpaid balance of a long leverage contract, and periodic payment or  
9 crediting by the leverage transaction merchant to the leverage customer  
10 of a variable carrying charge or fee on the initial value of the contract  
11 plus any margin deposits made by the leverage customer in connection  
12 with a short leverage contract;
- 13 (4) Delivery of a commodity in an amount and form which can be  
14 readily purchased and sold in normal commercial or retail channels;
- 15 (5) Delivery of the leverage commodity after satisfaction of the balance  
16 due on the contract; and
- 17 (6) Determination of the contract purchase and repurchase, or sale and  
18 resale prices by the leverage transaction merchant.

19 17 C.F.R. § 31.4(w).

20 Recognizing that 20/20 Metals' contracts do not qualify as leverage contracts, the  
21 CFTC argues that Regulation 31.4(w) is "irrelevant" and that its jurisdiction under 7  
22 U.S.C. § 23 encompasses more than leverage contracts. Put simply, the CFTC argues that  
23 20/20 Metals' contracts qualify as Section 19 contracts, but are not leverage contracts.  
24 Throughout its briefs, the CFTC uses "Section 19 contracts" broadly to mean those  
25 transactions falling under 7 U.S.C. § 23. This broad terminology, however, has not been  
26 adopted by the courts. Indeed, only one court refers to transactions falling under 7 U.S.C.  
27 § 23 as Section 19 contracts, and that case was decided before the CFTC set forth the  
28 definition of leverage contract under Regulation 31.4(w) in 1984. *See Breyer v. First Nat.*

1 *Monetary Corp.*, 548 F. Supp. 955 (D.N.J 1982). Even then, the court in *Breyer* defines a  
2 Section 19 contract as “a standardized contract commonly known in the trade as a . . .  
3 leverage account or leverage contract.” *Id.* at 964 (quoting 7 U.S.C. § 23(a)). Instead,  
4 courts generally have used the term leverage contract to encompass 7 U.S.C. § 23(a). *See,*  
5 *e.g.*, *Galvin v. First Nat. Monetary Corp.*, 624 F. Supp. 154, 156 (E.D.N.Y. 1985) (noting  
6 that “[a] leverage contract . . . is defined by Congress, albeit circuitously, as” the definition  
7 found in 7 U.S.C. section 23(a)).

8 Furthermore, the CFTC fails to explain how Section 19 contracts could be anything  
9 but leverage contracts or the functional equivalent. The plain language of 7 U.S.C. § 23  
10 uses margin account, margin contract, leverage account, or leverage contract  
11 synonymously to define the type of standardized contract governed by the statute. The  
12 CFTC does not argue that 20/20 Metals’ contracts were margin contracts or accounts, as  
13 they are the equivalent to leverage contracts. Any other type of “contract, account,  
14 arrangement, scheme, or device” that “serves the same function or functions *as such a*  
15 standardized contract, or is marketed or managed in substantially the same manner *as such*  
16 *a* standardized contract,” must be the functional equivalent of “such a standardized  
17 contract,” i.e., a leverage contract. 7 U.S.C. § 23(a) (emphasis added). Instead, the CFTC  
18 relies on language from a 1978 Senate Report, S. Rep. No. 95-850, that accompanied the  
19 passing of the Futures Trading Act of 1978, Pub. L. No. 95-405, which instituted Section  
20 19 of the Act, to argue that 20/20 Metals transactions fall under 7 U.S.C. § 23. (*See* Pl.’s  
21 Mot. at 6-7 nn. 2-3.) This argument fails for two reasons. First, Senate Report 95-850  
22 attempted to define leverage contract, the very term from which the CFTC attempts to  
23 distance itself. The Report noted: “Generally, the *leverage contract* currently in use in an  
24 agreement for the purchase or sale of a contract for the delivery at a later date of a  
25 specified commodity in a standard unit and quality, or the close-out of the contract by an  
26 offsetting transaction.” S. Rep. No. 95-850 at 25 (1978) (emphasis added). The Report  
27 then stated that the “principal characteristics of the contract include”:  
28 (1) Standard units, quality, and terms and conditions;

1 (2) Payment and maintenance or ‘margin’;

2 (3) Close-out by an offsetting transaction or by delivery, after payment in full; and

3 (4) No right or interest in a specific lot of the commodity.

4 *Id.* With the CFTC formally defining leverage contract in Regulation 31.4(w) six years  
5 after Senate Report 95-850, Senate Report 95-850’s definition, if ever controlling, was  
6 superseded. Second, no other court has utilized the characteristics in Senate Report 95-850  
7 to find that a contract or transaction fell under the scope of 7 U.S.C. § 23. Indeed, the only  
8 case that the CFTC points to in support of this argument, *Arizona v. Smythe-Wheatley,*  
9 *Ltd.*, Civ. No. 84-243 (D. Ariz. Feb. 17, 1984 and Dec. 15, 1987), addressed claims for  
10 “leverage contracts” and utilized the definition in Regulation 31.4(w). (See Appx. Pl.’s  
11 Mem., Doc. 5, at 294, 333-334.)

12 Moreover, in 1984, the CFTC adopted interim final rules in connection with its  
13 regulation of leverage transactions under 7 U.S.C. § 23 and its defining leverage contract  
14 in Rule 31.4(w). *See* 49 Fed. Reg. 5498 (1984); *CFTC v. P.I.E., Inc.*, 853 F.2d 721, 724  
15 (9th Cir. 1988) (relying on 49 Federal Regulation 5498 in interpreting the Act); *In re*  
16 *Bybee*, 945 F.2d 309, 314-15 (9th Cir. 1991) (instructing that when a court interprets and  
17 applies the Act, it should give “great deference to the Commission’s interpretation”  
18 (quoting *P.I.E.*, 853 F.2d at 724)). In those rules, the CFTC stated that by defining  
19 leverage contract in Regulation 31.4(w), the CFTC had “exercised its authority to specify  
20 the standardized contracts that Congress expected to be regulated under Section 19 of the  
21 Act.” 49 Fed. Reg. at 5498. The CFTC delineated that “those transactions that do not  
22 meet the Commission’s definition of a leverage contract are not within the Commission’s  
23 regulatory jurisdiction under Section 19 of the Act . . . .” *Id.* “This ‘bright line’ distinction  
24 between transactions subject to exclusive Commission jurisdiction under Section 19 and  
25 those not subject to Commission regulation thereunder is one of the salutary effects of the  
26 comprehensive definition adopted by the Commission.” *Id.* In addition, on August 6,  
27 1985, the CFTC issued Interpretative Letter No. 85-2 which contemplated whether certain  
28 transactions involving the purchase and sale of precious metals qualified as leverage

1 contracts under 7 U.S.C. § 23 or futures contracts under 7 U.S.C. § 6(a) and were therefore  
2 subject to regulation under the Act. (*Bank Activities Involving the Sale of Precious Metals*,  
3 Comm. Fut. L. Rep. (CCH) ¶ 22,673 (CFTC Aug. 6, 1985); *see* Feigin Decl., Doc. 32, ¶  
4 Exh. E at 1-2.)<sup>2</sup> As the CFTC noted: “In analyzing whether these transactions are subject  
5 to regulation under the Commodity Exchange Act, it is necessary to determine whether the  
6 transactions may be either leverage contracts [or] transactions involving contracts of sale  
7 of a commodity for future delivery within the meaning of the Act and applicable  
8 Commission regulations.” (*Id.* at 2.) The transactions at issue in that opinion letter were  
9 strikingly similar to those in this case: dealers would purchase precious metals from a  
10 bank, the bank would either deliver the metals to the dealer or segregate them in holding  
11 vaults, the dealer would resell the metals to retail customers in exchange for full payments  
12 or payments pursuant to a financing agreement that were completed within two to seven  
13 business days, and the dealer would direct the bank to transfer title of the metals to the  
14 customers. (*Id.* at 1.) In the CFTC’s opinion, the transactions did not qualify as leverage  
15 contracts, and therefore did not fall under 7 U.S.C. § 23, because they were not ten years or  
16 more in duration as required by Regulation 31.4(w). (*Id.*) Thus, from the plain language  
17 of 7 U.S.C. § 23, the rules set forth by the CFTC in connection with promulgating the  
18 regulatory scheme that governs the statute, and an opinion<sup>3</sup> issued by the CFTC when it  
19 applied the statute to similar facts as arise here, it is clear that leverage contracts constitute  
20 the exclusive type of transactions governed by 7 U.S.C. § 23.

---

21

22 <sup>2</sup> Defendants state in their opposition brief that Interpretative Letter No. 85-2 (August 6, 1985)  
23 is “attached hereto as Exhibit H.” As the Court noted at the June 6, 2011 hearing, Defendants did  
24 not attach to its opposition brief an Exhibit H, nor Exhibits A-G or J. (See, for example,  
25 Defendants’ opposition brief on page 14 citing to “Exhibit J.”) Instead, Defendants attached the  
26 exhibits to declarations submitted by Defendant Adatia and their expert witness Phillip Feigin,  
27 with different exhibit letters and numbers than those referenced in the opposition brief.  
28 Interpretative Letter No. 85-2 appears as Exhibit E to Feigin’s declaration.

29 <sup>3</sup> In Interpretative Letter No. 85-2, the CFTC states that “the analysis set forth above is not  
30 necessarily that of the Commission and concerns only the applicability of the Commodity  
31 Exchange Act . . . to the transactions you have described . . . .” *Bank Activities Involving the Sale*  
32 *of Precious Metals*, Comm. Fut. L. Rep. (CCH) ¶ 22,673 at 4 (CFTC Aug. 6, 1985).

1                   D. 20/20 Metals' Contracts Are Not Leverage Contracts and A Preliminary  
2                   Injunction Is Not Proper

3                   The CFTC has failed to provide any evidence that the 20/20 Metals' contracts  
4                   qualify as leverage contracts. As noted above, the CFTC argues that the definition of  
5                   leverage contract in Regulation 31.4(w) is irrelevant. (Pl.'s Reply at 6-7.) In fact, the  
6                   CFTC conceded at oral argument that, if Section 19 contracts are nothing more than  
7                   leverage contracts as defined by Rule 31.4(w), they lack jurisdiction over claims three and  
8                   four.<sup>4</sup> Nonetheless, the Court notes that there is no evidence that the contracts in question  
9                   were standardized, that the contracts were for longer than 10 years, or that customers were  
10                  required to maintain margin payments. For example, on the issue of duration, Defendants  
11                  maintain that the maximum term of the contracts in question was for four years, and have  
12                  provided declarations from customers attesting to this fact. (See, e.g., Colacchio Decl.,  
13                  Doc. 37, ¶ 7; Engle Decl., Doc. 38, ¶ 7; Kavusak Decl., Doc. 39, ¶ 7.) The Ninth Circuit  
14                  has held that a contract with a duration of less than ten years does not qualify as a leverage  
15                  contract. *In re Bybee*, 945 F.2d at 312 n.3 (“Under the Commission’s interpretation of the  
16                  Commodity Exchange Act, there can be no such thing as a leverage contract with a  
17                  duration of less than ten years.” (quoting *P.I.E.*, 853 F.2d at 724)); *P.I.E.*, 853 F.2d at 724  
18                  (“In 1984, the Commission determined that one definitional requirement of a leveraged  
19                  contract was that the contract must be for a duration of ten or more years.”); *see First*  
20                  *National*, 860 F.2d at 658 (“[Plaintiff’s] ‘cash forward’ contracts would not constitute  
21                  leverage contracts under these regulations because, *inter alia*, they fail to satisfy the  
22                  durational requirement (ten years or longer) . . . .”); *see also Chang Ming Li v. Gain*  
23                  *Capital Grp., LLC*, 2011 CFTC Lexis 15, at \*12 (Feb. 8, 2011) (“Although not readily  
24                  apparent from its language, it suffices to note that Section 19’s regulatory jurisdiction is

---

25  
26                  <sup>4</sup> The CFTC devotes three sentences in its reply brief to the argument that Defendants’  
27                  transactions in palladium and copper are *per se* violations of Section 19(b). (Pl.'s Reply at 21-22.)  
28                  There is no basis for this argument as the transactions must still qualify as leverage contracts to  
                        fall under the jurisdiction of 7 U.S.C. § 23.

1 limited to a narrowly defined set of specifically conditioned contracts of ten years or  
2 longer.”).

3 The Ninth Circuit came to an instructive conclusion when addressing a similar  
4 situation in *P.I.E.* 853 F.2d at 723. The court in *P.I.E.* had to decide whether certain  
5 precious metals contracts were futures contracts or leverage contracts:

6       A. Futures contract or leverage contract

7 [Defendant’s] contracts provided a means for investors to speculate in  
8 the precious metals market. Customers dealt directly with [defendant],  
9 choosing a type and quantity of metal and then deciding whether  
10 delivery would be deferred for 90, 180, or 360 days. [Defendant] set  
11 the price by reference to the current market price of the metal for  
12 immediate delivery, plus a 3% commission and a surcharge.  
13 Customers paid a 15% deposit up front and made margin payments at  
14 [defendant’s] behest if the price of the metal declined during the term  
15 of the contract. Customers rarely took delivery of the metal. Instead  
16 they sold their rights to the metal back to [defendant], which then  
17 settled the customers’ respective accounts.

18 [Defendant’s] contracts can only be classified in one of two ways: they  
19 are either futures contracts or *leverage contracts*.

20 *Id.* at 723. The court in *P.I.E.* found that the contracts in question were not leverage  
21 contracts because they did not satisfy the ten-year durational requirement under Regulation  
22 31.4(w). *Id.* at 724. In this case, the transactions underlying claims three and four are not  
23 ten years or more in duration and do not qualify as leverage contracts, and therefore  
24 leverage transactions, under 7 U.S.C. § 23. Thus, the CFTC lacks jurisdiction over claims  
25 three and four and, as a result, cannot show a likelihood of success or raise serious  
26 questions as to the merits of those claims to warrant a preliminary injunction.

27

28

1                   **VI. CONCLUSION**

2                   Accordingly, the Court DENIES the motion for a preliminary injunction, dissolves  
3 the statutory restraining order, and terminates immediately the temporary receiver's  
4 appointment. The Court orders the temporary receiver to return promptly any assets or  
5 property frozen or seized pursuant to the statutory restraining order.

6

7 DATED: June 7, 2011

8                   **JOSEPHINE STATON TUCKER**  
9                   JOSEPHINE STATON TUCKER  
10                   UNITED STATES DISTRICT JUDGE

11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28